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Army Commissary Accounting for Gains and Losses Needs Improvement. FGMSD-78-43; E-146875, July 17, 1978. 2 pp. + 2 appendices (13 pp.).

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Directive 7420.1. Army Regulation 735-11. Army Regulation 30-19.

Army commissaries are financed from appropriated funds, a revolving stock fund, and revenues from retail sales. Although by law merchandise must be sold at cost, a surcharge may be added to pay certain operating expenses. Money collected in excess of the amount required to reimburse the stock fund for operating expenses is used for commissary construction and improvements. Except for inventory losses and changes in inventory levels, sales receipts should generally equal the cost of purchases paid from the stock fund. Findings/Conclusions: From July 1974 through September 1976, the Army stock fund absorbed \$9.5 million in commissary losses from unidentifiable causes. These losses should be borne by commissary customers. Also, discounts earned by the fund from prompt payment for purchases, which totaled \$1.2 million for the first 9 months of 1977, should have been passed on to the commissary patrons but were not. Recommendations: The Secretary of Defense should require the Secretary of the Army to revise procedures to provide that the Army stock fund be reimbursed for all inventory losses resulting from identifiable causes beginning with fiscal year 1977; reimburse the Army stock fund for operating losses from unidentifiable causes which were absorbed at the time inventory accountability was transferred to the Troop Support Agency; complete processing of reports of the survey which were initiated before the transfer of accountability; revise procedures to provide that all discounts earned by prompt payment be transferred to the surcharge trust fund; and establish a variance account to separately record the difference between purchase prices and shelf prices. (Author/SC)

7022

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

Army Commissary Accounting For Gains And Losses Needs Improvement

From July 1974 through September 1976, the Army stock fund absorbed \$9.5 million in commissary losses from unidentifiable causes. These losses should be borne by commissary customers. Also, discounts earned by the fund from prompt payment for purchases, which totaled \$1.2 million for the first 9 months of 1977, should have been passed on to commissary patrons but were not. The accounting system for Army commissaries should be revised to insure proper handling of these inventory losses and gains.

The Department of Defense said that (1) it will change its policy to reimburse the stock fund for all operating losses from unidentifiable causes and (2) action had been or will be taken to carry out GAO's recommendations.



FGMSD-78-43
JULY 17, 1978



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-146875

To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the results of the Army's system of accounting for inventory gains and losses from commissary operations. In a March 19, 1975, report to the Chairman of the House Committee on Appropriations titled "Information on Commissary Store Operations" (FPCD-75-132), we reported that most commissary inventory losses from unidentifiable causes were absorbed by the Army stock fund and were not borne by the customer as intended by law. Our followup work showed that the Army continued this practice through fiscal year 1977.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67). Section 112 (b) of the 1950 act provides that the Comptroller General approve all accounting systems. The Army has not submitted its commissaries' accounting system for approval.

Appendix I of this report contains our findings, conclusions, and recommendations. Briefly, we recommend that the Secretary of Defense make certain that:

- All commissary inventory losses from unidentifiable causes are borne by commissary customers.
- All discounts obtained by commissaries for prompt payment are passed on to customers in the form of lower prices.
- Inventory gains and losses are separately accounted for in order to provide Army commissary managers maximum visibility over losses.

The Department of Defense agreed with our recommendations, and the Army will implement them. (See app. II.) We are providing the Army data to use in determining the proper reimbursements of its stock fund for inventory losses from unidentifiable causes. Action has been or will be taken to implement the other recommendations.

B-146875

We are sending copies of this report to the Director, Office of Management and Budget, and to the Secretaries of Defense and the Army, Navy, and Air Force.

A handwritten signature in black ink, appearing to read "Robert A. Atwell". The signature is written in a cursive style with a large, prominent initial "R".

Comptroller General
of the United States

SUMMARY OF GAO's FINDINGSAND RECOMMENDATIONS TO IMPROVE THE ARMY'SHANDLING OF COMMISSARY INVENTORY GAINS AND LOSSES

In 1977 the Army had 111 commissary stores and 33 branch stores which sold groceries, meats, produce, and household items to personnel of the uniformed services and their dependents. For fiscal year ended September 30, 1977, sales at the Army commissaries were \$1.042 billion.

These commissaries are financed from appropriated funds, a revolving stock fund, and revenues from retail sales. Commissary personnel costs may be paid from appropriated funds. The revolving stock fund provides working capital to finance resale inventories and pays certain commissary operating expenses which are subsequently reimbursed. The revenues from retail sales replenish the revolving stock fund.

By law, Army commissaries must sell merchandise at cost, but they may add a surcharge (currently 4 percent of sales) to pay certain operating expenses. Money collected in excess of the amount required to reimburse the stock fund for operating expenses is used for commissary construction and improvements.

Sales receipts are accounted for separately from surcharge receipts. Sales receipts are deposited to the Army stock fund for commissary operations, and bills for merchandise purchased for resale are paid from that fund. Thus, except for inventory losses and changes in inventory levels, sales receipts should generally equal the cost of purchases paid from the stock fund. Surcharge receipts are deposited in a surcharge trust fund managed by the Troop Support Agency at Fort Lee, Virginia.

At September 30, 1977, Army commissaries had a balance of \$33.5 million in surcharge funds. For the fiscal year ended September 30, 1977, surcharge fund collections were \$44.4 million compared to \$29.2 million in expenditures.

The Army accounts for commissary merchandise in a relatively simple manner. Each month, all merchandise receipts and price increases are added to the beginning inventory, while sales, destroyed merchandise (shrinkage and spoilage), and price reductions are deducted. The net figure is recorded in the accounting records as the value of the inventory. A physical inventory is taken and the value (considering shelf prices) is compared to inventory value in the

accounting records. The accounting records are then adjusted to the physical inventory amount, and the gain or loss is reflected by an increase or decrease in the stock fund.

The Army attempts to determine the cause of any gains or losses so that corrective action can be taken. If the cause cannot be identified, the gain or loss is accumulated in a separate account. When the cumulative gains or losses in this account exceed an established tolerance, a full investigation is made to identify the causes.

The investigative results are summarized in a report of survey which states circumstances concerning the loss. The report is used to adjust the inventory balance in the accounting records and to determine the responsibility for the loss. The report is processed from the originating installation through the command structure to the Troop Support Agency. At the conclusion of the report process, the stock fund is reimbursed from the surcharge fund for the amount of the loss considered appropriate by the approving official.

In July 1975 the Secretary of Defense directed the Army to implement a centralized management system for its commissaries. In 1976 and 1977, control of the Army commissaries was transferred from the installation commanders to the Troop Support Agency. Also in April 1976, the Department of Defense directed the Air Force to develop a standard Defense-wide accounting system for commissary stores. This system has not been developed and submitted for approval by the Comptroller General.

STOCK FUND NOT REIMBURSED FOR LOSSES FROM UNIDENTIFIABLE CAUSES

The Army stock fund should not absorb inventory losses from unidentifiable causes; instead, the stock fund should be reimbursed from surcharges collected on purchases by commissary patrons. However, from July 1974 through September 1976, the Army stock fund absorbed \$9.5 million in commissary inventory losses from unidentifiable causes, as follows:

- \$3.4 million in losses was not reimbursed because the Army policy was to allocate losses between the non-appropriated or surcharge fund and the stock fund.
- \$1.4 million was charged to the stock fund when accountability for commissary inventories was centralized. Losses previously accumulated were not reimbursed.

--\$4.7 million in losses from unidentifiable causes was not reimbursed because reports of survey were not processed.

Army allocated \$3.4 million
in losses to the stock fund

The \$3.4 million in unidentifiable commissary store losses, which were absorbed by the Army stock fund from July 1974 through September 1976, should have been, by law, absorbed by the surcharge trust fund. These losses were the difference between stock onhand and the recorded inventory balance, as adjusted for known spoilage and shrinkage. Army commissary customers paid 20 percent of these losses of over \$4 million and the remaining 80 percent was absorbed by the stock fund. An additional \$896,749 in such losses was accumulated during the 6-month period ended March 31, 1977, and, unless the system of reimbursement is changed, these losses will be absorbed by the stock fund.

Since 1950 annual Department of Defense appropriation acts have required commissaries to reimburse appropriations (specifically stock funds)--through sales price adjustments--for certain inventory losses, including those for shrinkage, spoilage, and pilferage. ¹/ According to a 1962 Department of the Army legal opinion interpreting this recurring provision, losses due to shrinkage and spoilage are identifiable, accounted for separately, and reimbursed to the Army stock fund. The opinion stated that unidentifiable losses fell into five categories--accounting errors, pricing errors, ring-up losses, inventory errors, and pilferage--and that only pilferage, by law, must be paid from surcharge funds. Based on an estimate that each of these five categories represents an equal part of unidentifiable losses, the Army has traditionally charged 20 percent of the total unidentifiable losses to surcharge funds; the remaining 80 percent has been charged to the stock fund.

During this review, we expressed concern to the Army's General Counsel over the authority which the Army commissaries use for not reimbursing the stock fund for the full balance of unidentifiable losses. Although the recurring provision in the Defense annual appropriations act mentions only pilferage as an unidentifiable loss for which commissaries are to reimburse appropriations,

¹/See, for example, section 814 of Public Law 93-437 and section 714 of Public Law 94-419.

31 U.S.C. 628 requires that appropriated funds be expended solely for the objects for which appropriated, and we could find no specific authority for the stock fund to absorb 80 percent of the unidentifiable inventory losses.

This procedure also conflicted with Defense Directive 7420.1, which required that stock funds be reimbursed for all normal operating losses. The Army categorizes unidentifiable inventory losses as normal operating losses. Further, the allocation conflicts with the expressed congressional intent that all of the armed services' commissaries reimburse appropriations for operating losses on the same basis. The Navy, Marine Corps, and Air Force all require full reimbursement for unidentifiable inventory losses.

An October 13, 1977, letter from the Army's General Counsel stated that beginning in fiscal year 1978 the Army would, as a matter of policy, reimburse the stock fund for all its commissaries' unidentifiable inventory losses. However, the Army's practice of limited reimbursement of appropriated funds, which conflicts with legislative intent and Defense directives, has been in effect for several years. We questioned this practice in our report to the House Committee on Appropriations entitled "Information on Commissary Store Operations" (FPCD-75-132, Mar. 19, 1975). We also discussed this matter, in detail, with responsible Army personnel.

For these reasons, we believe, as a minimum, the Army should begin fully reimbursing the Army stock fund for unidentifiable inventory losses beginning with fiscal year 1977.

Unidentifiable losses of \$1.4 million written off when inventory accountability was transferred

Unidentifiable inventory losses of \$1.4 million were erroneously charged to the Army stock fund when accountability for commissary inventories was transferred from the installations to the Troop Support Agency. The stock fund was not reimbursed from surcharge funds as required by law.

Title 31, section 628, United States Code, requires that appropriated funds (stock funds in this case) be used only for the purpose for which appropriated, and we could find no specific or general authority for the stock fund to absorb such losses. Also, this practice conflicted with Defense Directive 7420.1, dated January 26, 1967. This directive

required the stock fund to be reimbursed for all normal operating losses.

The transfer of commissary store accountability to the Troop Support Agency during 1976 and 1977 included the designation of a new division of the Army stock fund specifically for commissary operations. When control and accountability was transferred, a physical inventory was taken to confirm or adjust the value of the inventory in the accounting records before the transfer. Net inventory losses totaling \$1,191,784 were processed through the subsistence division of the Army stock fund as an accounting adjustment. In addition, before the transfer, several commissary stores wrote off unidentifiable losses totaling \$236,769 due to administrative error. These stores took a physical inventory in December 1975 and made the writeoff to the stock fund at that time. This required another physical inventory in 1976, when accountability was transferred, to assure that the accounting records were accurate.

The \$1.4 million unidentifiable losses were absorbed by the Army stock fund instead of the commissary surcharge fund, as required by law, during the transfer of commissary inventory accountability to the Troop Support Agency.

On August 10, 1977, we raised certain questions concerning the reimbursement of appropriated funds by the surcharge funds in connection with the Army commissary system. The Army's General Counsel responded on October 13, 1977, that full reimbursement would be made when final computations were completed for adjustments made when inventory accountability was transferred to the Troop Support Agency.

Unidentifiable losses of \$4.7 million approved by reports of survey but not reimbursed to the stock fund

From July 1974 through September 1976, reports of survey for at least \$4.7 million in losses from unidentifiable causes were not processed and, therefore, the Army stock fund was not reimbursed.

Army Regulation 735-11 requires a report of survey to be prepared when Army property, including commissary inventory, is lost, damaged, or stolen. This report of survey is designed to fix responsibility for the loss. If the loss is found not to be due to fault or neglect of the commissary officer, the officer is granted relief from property responsibility.

Before accountability for commissary inventories was transferred to the Troop Support Agency, reports of survey were required to be processed through the major Army command to the Troop Support Agency. However, we located some unprocessed reports of survey by comparing the surcharge fund reimbursement to lists of reports of survey at two major commands. We then had the Troop Support Agency contact all commissaries in the continental United States to determine if other reports of survey had not been processed. A total of 48 unprocessed reports of survey for \$4,658,631 in losses were located.

Army commissary operating regulations required that the commissary officer forward one copy of approved reports of survey to the surcharge fund manager. However, management controls could not make certain that reports were forwarded. Under the central management system, reports of survey will be processed because the Troop Support Agency manages both the commissary stock fund and the surcharge fund. In addition, the Troop Support Agency must approve the reports of survey.

Because the reports of survey were not fully processed, the commissary surcharge fund did not reimburse the Army stock fund. This reimbursement is essential to maintain the capital amount of the Army stock fund.

CONCLUSIONS

The Army stock fund should not absorb commissary inventory losses from unidentifiable causes. Instead, these losses should be borne by commissary patrons through the surcharge trust funds, as intended by law. Therefore, the Army should make certain that commissary inventory losses from unidentifiable causes are absorbed by the surcharge trust funds.

RECOMMENDATIONS

We recommend that the Secretary of Defense require the Secretary of the Army to

- revise procedures to provide that the Army stock fund be reimbursed for all inventory losses resulting from unidentifiable causes beginning with fiscal year 1977,
- reimburse the Army stock fund for operating losses from unidentifiable causes which were absorbed at the

time inventory accountability was transferred to the Troop Support Agency, and

--complete processing of reports of survey which were initiated before the transfer of accountability.

AGENCY COMMENTS

The Department of Defense agreed with our recommendations and stated that the Army would implement them. They also stated that they would need pertinent backup audit data to determine the proper stock fund reimbursements. Arrangements were made to provide this data to the Troop Support Agency. (See app. II.)

DISCOUNTS FOR PROMPT PAYMENT NOT PASSED ON TO CUSTOMERS

Cash discounts totaling \$1.2 million for the first 9 months of fiscal year 1977 were not considered in pricing goods. These discounts should have been passed on to commissary patrons.

The law requires that the Army commissaries sell merchandise at cost. Army regulations specify that discounts earned for prompt payment of invoices and which exceed 2 percent will be deducted from the invoice price. Thus, when the inventory is purchased for commissary resale, the commissary is charged, and receipt is recorded in the inventory account at the net inventory price. Under these regulations, the cost of the merchandise is reduced by the discount earned and the savings are passed on to the commissary patron.

However, when the discount earned by prompt payment of the invoice is 2 percent or less, which is usually the case, the discount is not considered in pricing the merchandise for resale. Under this system, the price paid by the commissary patron is in excess of the cost incurred by the stock fund. As a result, gains from discounts earned of 2 percent or less are absorbed by the stock fund.

Before fiscal year 1977, Army records were not maintained to show the amount of such cash discounts applicable to commissary sales. For the first 9 months of fiscal year 1977, these discounts of 2 percent or less were \$1.2 million.

A limited review of Air Force regulations and discussion with responsible personnel showed that this service did not

pass the cash discounts on to patrons when the discount involved was 2 percent or less of the purchase price. The Air Force subsequently revised its procedures to provide that all cash discounts earned are included in the computation of reimbursements from the commissary trust revolving fund to the stock fund for reimbursable operating losses. The balance in the surcharge trust funds account is considered in determining the surcharge rate applied to future purchases by commissary patrons.

Cash discounts on purchases of commissary merchandise accrue to the Army stock fund without benefitting commissary customers. The discounts are reported as part of commissary operating results, but the customer does not benefit through transfer of the gain to the commissary surcharge fund. We believe these discounts should be passed on to commissary patrons by transferring the amount of discounts earned to the surcharge trust fund.

RECOMMENDATION

We recommend that the Secretary of Defense have the Secretary of the Army revise procedures to provide that all discounts earned by prompt payment be transferred to the surcharge trust fund.

AGENCY COMMENTS

The Department of Defense agreed with our recommendation and stated that reimbursement procedures would be revised to include discounts earned on purchases. (See app. II.)

ACCOUNTING FOR GAINS AND LOSSES NEEDS IMPROVEMENTS

Inventory gains and losses are not readily visible to Army commissary management because the accounting system does not separately account for these items. The system does not isolate gains which result when the total merchandise sales price exceeds the total purchase price because of individual item price adjustments. Instead, these gains are netted in the accounting records against inventory losses from unidentifiable causes. As a result, the amount of these losses is unknown.

Merchandise is recorded in the inventory control account at purchase price, based on invoice cost. Shelf (sales) prices are slightly higher because of price adjustments which allow items to be sold at whole cents per unit (can, jar,

box, etc.). As items are sold at the higher prices, a gain results, but the amount of this gain is not segregated by the accounting system. Instead, when a physical inventory is taken, inventory value at shelf price is matched against the inventory control account to determine the net gain or loss. The gross gains resulting from the pricing adjustments are offset in the inventory control account against gross losses from unidentifiable causes to arrive at the net gain or loss. As a result, only this net amount is known.

The Air Force's accounting system discloses gross gains and losses. It uses a variance account which separately records the difference (gain) between shelf price and purchase price for each item. Thus, a matching of the physical inventory value with the inventory account pinpoints the actual inventory loss from unidentifiable causes. Management then knows what its true inventory gains and losses are and has a better basis for determining needed corrective action.

RECOMMENDATION

We recommend that the Secretary of Defense have the Secretary of the Army establish a variance account to separately record the difference between purchase prices and shelf prices.

AGENCY COMMENTS

The Department of Defense agreed with our recommendation and the Army will use a variance account to record the difference between purchase prices and shelf prices. (See app. II.)

SCOPE OF REVIEW

We reviewed Army policies and procedures for handling commissary gains and losses from unidentifiable causes. We tested selected transactions and reviewed reports of commissary operations from July 1974 through September 1976. We obtained more current data, when available.

We did not review all aspects of the Army commissary accounting system. Rather, we concentrated our efforts on the Army's handling of gains and losses incurred through the normal course of business. Although we limited our review to the Army, we obtained information on Air Force and Navy accounting policies for handling gains and losses.

We obtained data from commissary financial and management reports and from commissary stores' accounting records. We requested data from all Army commissary stores in the continental United States to verify and update the financial and management reports; however, about 20 percent did not reply. For those not replying, we used management's report data.

We visited the Army Troop Support Agency, Fort Lee, Virginia, and the Air Force Commissary Services Command, Kelly Air Force Base, Texas. These activities are the Army and Air Force worldwide financial and operational managers for the services' commissaries. In addition, we visited five Army commissary stores and two major Army command headquarters. We discussed past and present commissary accounting policies with officials at the Departments of Defense and the Army, and with the Army Troop Support Agency.



COMPTROLLER

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C. 20301

15 MAY 1978

Mr. D. L. Scantlebury
Director, Division of Financial
and General Management Studies
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Scantlebury:

This is in reply to your letter to the Secretary of Defense regarding your report dated March 7, 1978, on "Stock Fund Integrity Impaired by Army Accounting for Commissary Gains and Losses" (OSD Case #4836) (GAO Code 90124).

We agree with the recommendations. The Army will implement them. However, because of the decentralized operation in the Army prior to 1976, implementation of certain of the recommendations will require pertinent backup audit data which you have developed. We assume that this data could be made available with no difficulty at the Army's request.

Enclosed are our specific comments on your recommendations.

Sincerely,

Fred P. Wacker
Assistant Secretary of Defense

Enclosure



1. GAO recommendation: Revise procedures to reimburse the Army stock fund for all inventory losses from unidentified causes, beginning with Fiscal Year 1977.

OSD position: The following revised reimbursement procedures will be published in Army Regulation 30-19, Army Commissary Store Operations. The stock fund will be reimbursed for unidentified inventory losses retroactively, to include Fiscal Year 1977.

"Reimbursement for Losses. Reimbursement for identifiable and unidentifiable losses from the Trust Revolving Fund Account to the Commissary Resale Division of the Army Stock Fund (CORDASF) will be accomplished at the end of each fiscal year. Reimbursement will be based on the net amount reflected in 21X4991.0832 (CORDASF) General Ledger Account 3015, Operating Results, less accounting adjustments and a percentage of the amount applicable for sales to appropriated fund activities. A net loss at the end of the fiscal year would result in a reimbursement from TRFA to CORDASF. A net gain would be carried forward and applied to losses occurring in the next fiscal year. Approved reports of survey and consolidated statements of gains and losses would be analyzed to ensure that gains and losses reflected in these documents have been considered in determining the net operating results reflected at the end of the fiscal year."

2. GAO recommendation: Reimburse the Army stock fund for operating losses from unidentifiable causes which were absorbed at the time inventory accountability was transferred to the Troop Support Agency.

OSD position: The Army will ask the GAO audit team for the documents which identify the losses. The Troop Support Agency does not have a record.

3. GAO recommendation: Complete processing of reports of survey which were initiated before the transfer of accountability.

OSD position: Inquiries by the GAO audit team, disclosed that the Troop Support Agency did not have all reports of survey initiated by installations. In most cases, the Troop Support Agency did not have the initial or the validated copy of the reports and could not act appropriately. The Army will ask the GAO audit team for the backup audit data so that the stock fund can be reimbursed for the losses.

4. GAO recommendation: Revise procedures to transfer the amount of discounts earned by prompt payment to the trust revolving fund account (TRFA).

OSD position: Reimbursement procedures will include the Army's General Ledger Account 6701 (discounts earned on purchases).

5. GAO recommendation: Establish a variance account to separately record the difference between purchase prices and shelf prices.

OSD position: The Army will use General Ledger Account 6729, Purchase Price Variance, to reflect the difference between standard price (selling and shelf price) and the cost price.